CURRENT BROADCAST NETWORK NATIONAL REACH[108]

	FCC %	FULL%
Fox	34.9	40.5
Paxson	30.9	61.4[109]
CBS	30.8	31.7
NBC	26.9	27.3
Tribune	26.5	37.5
ABC	23.9	24.2
Chris Craft/BHC Communications/ United Television	18.7	21.6
Gannett	16.5	16.6
USA	15.5	31.0
A.H. Belo	14.2	14.2
Univision	13.5	27.0

In 1995, the Commission conducted a competitive analysis "to examine the effects of relaxing [the broadcast ownership] rules on

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[108] See Broadcasting & Cable, April 6, 1998, at 46. Under **FCC%**, UHF stations are credited with 1/2 the market households. **FULL%** counts all households for UHF stations and LMAs.

[109] In its comments on the Commission's recent NOI regarding the broadcast ownership limit, Paxson stated: "Paxson currently owns 49 television stations nationwide; after the completion of pending transactions, it will own 69 stations nationwide representing **66.3**% of the television households in the country. Absent the UHF discount, Paxson's ownership interests would exceed the national cap." Comments of Paxson Communications Corporation in In the Matter of 1998 Biennial Regulatory Review -- Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, MM Docket No. 98-35, at 22 (July 21, 1998).

the potential competitiveness of the market" and "the diversity of viewpoints available to the public."[110] The Commission found that "liberalization of the national ownership limits would not have an adverse impact upon the competitiveness of the market," nor would it "have serious adverse effects on diversity."[111]

Indeed, the Commission proposed raising the national ownership limit, suggesting that the numerical station limit (i.e., the "one-to-a-market" rule) be eliminated entirely and that the "reach limit [be allowed] to increase by some fixed percentage, such as 5% every 3 years, until the reach limit rises to 50%, the final limit."[112] Consistent with these findings, in its latest NPRM on the issue, the Commission asked "whether this [35% national broadcast ownership] rule is no longer necessary in the public interest as the result of competition."[113]

In response to this inquiry, the broadcast networks asked the Commission to eliminate entirely their national horizontal limit. The networks argued that the limit prevents efficient grouping of

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[110] See In the Matter of Review of the Commission's Regulations Governing Television Broadcasting, Further Notice of Proposed Rulemaking, 10 FCC Rcd 3524, at ¶ 82 (1995).

[111] Id. at ¶ 99.

[112] Id. at ¶ 101.

[113] See In the Matter of 1998 Biennial Regulatory Review -- Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, MM Docket No. 98-35; Notice of Inquiry, FCC 98-37, at ¶ 16 (rel. March 13, 1998) ("Broadcast Ownership NOI").

broadcast stations which would promote economic efficiencies, improve the quality and diversity of programming, and increase capital investment in broadcast stations.[114] The networks also pointed out that the concerns of Congress and the Commission regarding diversity have been reduced in light of the continued growth of video outlets, including cable and other MVPDs.[115]

These points are essentially the same as those raised by TCI in these comments with regard to the cable horizontal limit. There is no reason why the Commission's relaxed approach to broadcast horizontal limits should not apply with equal force in the cable context. In fact, there are significant reasons to adopt an even higher limit in the cable context, perhaps most notably the ability of cable operators to build out their networks to provide competitive local telephony and interactive broadband offerings to American consumers. Also, TCI's 40% proposal is extremely conservative in light of the broadcasters' proposal to eliminate the broadcast horizontal limit in its entirety.

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[114] See Comments of CBS Corporation at 12-14; Comments of ABC, Inc. at 6,13; Comments of National Broadcasting Company, Inc. at 14-15; Joint Comments of Fox Television Stations, Inc. and USA Broadcasting, Inc. at 15-16, filed in Broadcast Ownership NOI (July 21, 1998).

[115] See Comments of CBS Corporation at 11; Comments of ABC, Inc. at 7-11; Comments of National Broadcasting Company, Inc. at 4-9; Joint Comments of Fox Televisions Stations, Inc. and USA Broadcasting, Inc. at 10-13, filed in Broadcast Ownership NOI (July 21, 1998).

c) Programming Services With Penetration Levels Well Below 60% Continue To Be Successful.

Many programming services have flourished at subscriber penetration levels well below 60% (the inverse of TCI's proposed limit of 40%). This fact further supports a 40% limit. The Commission agreed with this analysis in its Second Order on Recon. when it determined that a programmer that could not obtain carriage on an MSO with 30% penetration could still reach over 50 million subscribers,[116] more than enough subscribers for a programming network to be a national success.[117] The same is true if the horizontal limit is raised to 40%. Under this approach (using updated subscriber figures), a programmer that could not obtain carriage on an MSO with 40% penetration could still reach almost 47 million MVPD subscribers,[118] enough to be successful on a national level.

Programming networks with less than 47 million subscribers have had national success. For example, the Commission in its Second Order on Recon. points out that MSNBC, the Disney Channel, and Turner Classic Movies are among the top 50 programmers

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[116] The Commission calculated this result as follows: 73,646,970 (the number of MVPD subscribers cited in the Commission's 1997 annual competition report) minus 22,094,091 (30% x 73,646,970) = 51,552,879. See Second Order on Recon. at ¶ 45.

[117] Id.

[118] This is calculated as follows: 77,950,000 (the current number of MVPD subscribers, see NCTA Video Competition Comments at 6) minus 31,180,000 (40% x 77,950,000) = 46,770,000.

nationwide based on subscribership, and they reach substantially less than 40 million subscribers.[119] In addition, fX (35.9 million) and Nick at Nite's TV Land (24.8 million) are among the top 20 programmers based on Nielsen's prime time rating even though they have a subscribership of less than 47 million.[120] Many other programming networks have achieved long-term viability with less than 47 million subscribers. For example, Country Music Television, launched in March 1983, has 42.5 million subscribers; Bravo, launched in February 1980, has 32 million subscribers, and Knowledge TV, launched in November 1987, has 26 million subscribers.[121] On the following page is a chart listing examples of national programming services with subscriber penetration below 60%.

In fact, the Commission already has concluded that 10 to 20 million is the number of subscribers necessary for a new network to have long-term success.[122] Similarly, in the Commission's closed captioning proceeding, new cable programmers noted that the

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[119] Second Order on Recon. at ¶ 45.

[120] See Paul Kagan Assocs., Inc. "Average Prime-Time Ratings 1992-1997," Cable Program Investor, at 9 (March 13, 1998); Paul Kagan Assocs., Inc., "Network Census, April 30," Cable Program Investor, at 19 (June 12, 1998).

[121] See 1997 Video Competition Report at Tables F-1 and F-2; Cable Program Investor, at 19 (June 12, 1998).

[122] See 1996 Video Competition Report at ¶ 135 ("The available evidence suggests that a successful launch of a new mass market national programming network -- that is, the initial subscriber requirement for long-term success -- requires that the new channel be available to at least ten to twenty million households."); see

(continued ...)

Satellite Program Services with Penetration Below 60%

Satellite Program Service	Launch*	Current Subscribers**	Percent of DBS/DTH Subscribers*** 77,300,000
WGN-C	◆ Nov. 1978	43,500,000	55.8%
Country Music Television (CMT)	Mar. 1983	42,500,000	54.5%
Home & Garden Television	Dec. 1994	41,100,000	52.7%
Animal Planet	Oct. 1993	40,100,000	51.4%
MSNBC	Jul. 1996	39,000,000	50.0%
The Disney Channel	Apr. 1993	36,600,000	47.0%
Sneak Prevue	◆ Jan. 1992	36,000,000	46.2%
FX +	Oct. 1994	35,900,000	46.1%
Court TV	Aug. 1991	33,700,000	43.2%
TV Food Network	Nov. 1993	32,300,000	41.4%
Bravo	Feb. 1980	32,000,000	41.1%
Odyssey	Oct. 1993	30,100,000	38.6%
Fox News Channel	Oct. 1996	30,000,000	38.5%
Turner Classic Movies	Apr. 1994	27,000,000	34.6%
The Box Worldwide	Dec. 1985	26,000,000	33.4%
Knowledge TV	Nov. 1997	26,000,000	33.4%
Nick at Nite's TV Land +	Apr. 1996	24,800,000	31.8%
The Travel Channel	Mar. 1987	18,200,000	23.3%
The Golf Channel	Jan. 1995	15,000,000	19.2%
Speedvision	Dec. 1995	14,500,000	18.6%
Independent Film Channel	Sept. 1994	14,000,000	18.0%
Game Show Network	Dec. 1994	13,700,000	17.6%
Outdoor Life Network	Jul. 1995	13,500,000	17.3%
MuchMusic USA	Jul. 1994	12,900,000	16.5%
Classic Sports Network	May 1995	11,900,000	15.3%
The Inspirational Network	Apr. 1978	11,700,000	15.0%
CNN/SI	Dec. 1996	11,500,000	14.8%
Romance Classics	Jan. 1997	11,000,000	14.1%
M2	Aug. 1996	10,000,000	12.8%
CNN/fn	Dec. 1995	9,900,000	12.7%
Eye on People	Mar. 1997	9,000,000	11.5%
Q2	Sep. 1994	8,800,000	11.3%
FiT TV	Dec. 1993	8,300,000	10.6%
fXM	Nov. 1994	8,000,000	10.3%
American's Health Network	Mar. 1996	7,300,000	9.4%
International Channel	Jul. 1990	7,300,000	9.4%
ESPNEWS	Nov. 1996	7,000,000	9.0%
Goodlife TV Network[1/]	Feb. 1985	7,000,000	9.0%
Ovation	Apr. 1996	5,400,000	6.9%
BET on Jazz	Jan. 1996	4,500,000	5.8%

* Fourth Competition Report, FCC 97-423, at Tables F-2 and F-3 (rel. Jan. 13, 1998).

** As of April 1998. Paul Kagan Associates, Inc.; "Network Census, April 30," Cable Program Investor, at 19 (June 12, 1998).

*** Figure as of July, 1998 from NCTA Comments in Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Notice of Inquiry, CS Docket No. 98-102 (rel. June 26, 1998), at 6 (July 31, 1998).

\+ Among the top 20 programming networks based on Nielsen's prime-time ratings. Paul Kagan Assoc., Inc., "Average Prime-Time Ratings 1992-1997," Cable Program Investor, at 9 (March 13, 1998).

◆ Warren Publishing, Inc., Television & Cable Factbook, Services Vol. No. 66 (1998).

1/ Formerly Nostalgia Good TV.

national subscriber penetration threshold that is typically required to attract advertisers (one of the keys to long-term viability) is 10 to 20 million.[123] Thus, under a 40% limit, programmers would continue to have access to enough subscribers enabling them to have long-term success.[124]

* * *

In sum, the foregoing factors mean there are important benefits to be realized from allowing the current level of growth in the cable industry to continue and little reason to believe that such growth will have any negative impact on consumer welfare. Combined with this conclusion is the fact that establishing a horizontal limit is an inexact undertaking. The tools for measuring horizontal concentration and its effect on competition are simply not precise enough to allow the Commission to find the "perfect" horizontal limit. The Commission should acknowledge this fact and adopt a new horizontal limit that allows moderate, pro-

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(... continued)

also 1997 Video Competition Report at ¶¶ 155, 165 (citing 15 to 20 million as the critical number).

[123] Further NPRM at ¶ 44 (citing Comments of Outdoor Life Network, Speedvision Network, The Golf Channel, BET on Jazz, and America's Health Network at 11-13, 34, and 36, filed in Closed Captioning and Video Description of Video Programming, Implementation of Section 305 of the Telecommunications Act of 1996, Video Programming Accessibility, MM Docket No. 95-176)).

[124] See also Besen and Woodbury at 21 ("[E]vidence on the survivability of program services that are not integrated with cable operators provides many instances of services that [are] not vertically integrated [and] have existed for a very long period of time. Indeed, some of these are among the most successful program services.").

consumer growth to continue. TCI's proposal of a 40% MVPD subscriber-based limit accomplishes that goal.[125]

3. An MSO Should Be Permitted To Grow Internally Beyond The 40% Limit, But Should Be Required To Come Into Compliance With The 40% Limit When It Acquires A New System.

In the Further NPRM, the Commission asked whether a subscriber-based formula would have the effect of discouraging cable subscriber growth.[126] First, TCI notes that even if such a concern existed at the time of adoption of the original limit, it is much less of a problem today. Even if an MSO does not seek to increase aggressively its subscribership as a result of the horizontal limit, the potential harm to consumers is significantly less than in 1993 because consumers now have access to viable alternative MVPDs, most notably DBS, in any market of the country.[127]

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[125] TCI notes that as of 3/31/98, it served approximately 12.7 million cable subscribers in its wholly owned cable systems. Based on available data, and assuming the most conservative interpretation of the Commission's attribution rules, TCI estimates that as of 3/31/98, TCI and its MVPD affiliates served approximately 23.3 million subscribers. Finally, assuming all of the clustering transactions described above and in TCI's companion attribution comments were to close, and assuming again the most conservative application of the attribution rules, TCI estimates that TCI and its MVPD affiliates would serve approximately 25.6 million subscribers.

[126] Further NPRM at ¶ 86.

[127] See Besen and Woodbury at n. 20 ("This concern [that a subscriber-based formula might create disincentives for subscriber growth for an MSO] is attenuated today, since cable systems face competitive alternatives in every area of the county, and households that are discouraged from subscribing to cable have other alternatives.").

However, in the interest of avoiding such any negative incentive, TCI recommends that the Commission adopt the following approach: (1) any growth of subscribers in existing systems (as opposed to acquired systems) that causes an MSO to exceed the horizontal limit is permissible; and (2) any MSO that exceeds the limit in this fashion must come into compliance with the horizontal limit the next time it acquires a new cable system. The Department of Justice has advocated this approach:

> To the extent that general maximum size limits would apply to growth by internal expansion as well as growth by merger, they could create pricing and investment decisions that would harm consumer welfare.[128]

TCI's proposal also is analogous to the action taken by the Commission when it implemented the channel occupancy limits. There, the Commission grandfathered vertically integrated video programming services carried on a particular system as of a specified date where the 40% occupancy limit would otherwise have been exceeded. However, the Commission required that when such a system was upgraded, the operator could not add another vertically integrated program service until such system came into compliance with the 40% limit.[129] The Commission concluded that its action served the public interest since it prevented subscriber confusion and disruption to existing carriage agreements, as well as being consistent with Congress' intent that the Commission "take

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[128] See 1990 DOJ Reply Comments at 45, n.69 (emphasis added).

[129] 1993 Second Report and Order at ¶¶ 93-94.

particular account of the market structure, ownership patterns, and other relationships in the cable television industry" in establishing such limits.[130] This general approach is workable and fully justified in the context of the cable horizontal limit as well.

V. CONCLUSION

For the foregoing reasons, TCI respectfully urges the Commission to: (1) increase the cable horizontal limit to 40%; (2) adopt the MVPD subscriber-based test proposed in the Further NPRM; and (3) allow an MSO to grow internally beyond the 40% limit, but require the MSO to come into compliance with the 40% limit when it acquires a new system.

Respectfully submitted,

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[130] See id. at ¶ 94 (quoting 47 U.S.C. § 533(f)(2)(C)).

DESCRIPTION OF THE BENEFITS AND EFFICIENCIES OF CLUSTERING

- **Improved Maintenance And Customer Service**. Clustering enables a cable operator to centralize its customer service and maintenance functions to reduce the number of call centers and better position truck fleets to offer quicker and superior service. In addition, a cable operator's operating support and network management systems can be implemented more cost effectively. This, combined with the use of consistent components and architecture, allows for more sophisticated support systems that will aid in preventing outages and restoring service more quickly in the event of an outage.

- **Improved System Architecture Improvements**. Clustering enables cable operators to better design the architecture of their physical plant. For example, combining physically adjacent cable systems may make it possible to eliminate headends. A central headend can be utilized that connects to the outlying hubs by a fiber ring. This permits improved signal quality since off-air signals can be picked up at or near the broadcast source and satellite receivers can be located to avoid terrestrial interference and signal diminution. The use of a central headend also results in lower capital costs and cost savings associated with reductions in maintenance and materials, the offering of similar channel line-ups, and the use of common technical standards.

- **Interconnectivity And Ubiquitous Communications And Programming**. By establishing a regional network, cable operators can provide increased interconnectivity so that local origination, government, and educational channels can be aired to one, several, or all communities in the cluster. Institutional networks could obtain the same benefit because they would interconnect with a much larger base. This is particularly important to educators who wish to use interconnections for distance learning.

- **Clustering Promotes Regional Programming**. Regional programming services, such as news and sports, are often difficult for any single cable operator to develop if its systems cover only a fraction of a given metropolitan area. Efforts to develop and operate such programs with other cable operators can be cumbersome and inefficient. A cable operator's ability to spread the costs of programming over a greater number of

subscribers within a region increases the prospects of success and, therefore, the likelihood that the operator will incur the cost of developing local and regional programming.

- **Improved Sales Of Local And Regional Advertising**. Cable operators typically do not attract a share of local and regional advertising that is proportionate to the viewing of cable services. This is because any single cable system generally does not reach a sufficiently large audience to make cable advertising expenditures attractive. In order to reach an entire metropolitan area (or television ADI), for instance, advertisers may need to contact, and negotiate terms with, as many as 8-10 different cable operators. These hurdles are both time-consuming and expensive for local and regional advertisers.[131] Clustering substantially reduces these difficulties and therefore results in greater use of cable advertising by local and regional merchants and increased revenue for the cable operator. Cable becomes an important new competitor to serve the advertisers and, in the process, the customers.

- **Lower cost of promoting cable systems to potential subscribers**. Currently, it is difficult and expensive for cable operators to advertise their own services using radio, broadcast television, and local newspapers because a substantial portion of the audiences reached by such media are not served by the operator. Clustering increases the number of potential subscribers an operator can reach with each advertising dollar. In addition, clustering makes it easier to engage in more attractive joint consumer promotions with area retailers and others (e.g., McDonald's, local sports teams) because a cable operator's service area will more closely approximate the customer base of the other party.

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[131] Cable systems have attempted to deal with this problem by forming advertising cooperatives. However, such cooperatives are difficult to organize, frequently take years to develop, and often operate inefficiently (i.e., they typically require unanimous consent for key decisions, such as increased capital investments or commitments of advertising). The cooperative approach also involves substantial practical limitations, such as differing channel line-ups, which render cooperatives a poor alternative for advertisers.

- **Compatibility Of Set Top Boxes**. Clustering will promote the compatibility of set top boxes, which could result in several types of efficiencies, including reduced headend costs (systems can use one type of satellite receiver, transcoder, and modulator, as well as authorization computers that could serve an entire market), reduced inventories, consistent service offerings (such as interactive guides and VCR, television and remote control interfaces), and easier interoperability with consumer electronic equipment.

APPENDIX A

AN ECONOMIC ANALYSIS OF THE FCC'S CABLE OWNERSHIP RESTRICTIONS

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August 14, 1998

AN ECONOMIC ANALYSIS OF THE FCC'S CABLE OWNERSHIP RESTRICTIONS

Table of Contents

I. Introduction

Section 11 of the 1992 Cable Act requires the Commission to promulgate limits on cable system ownership. In an earlier report[1], we analyzed whether market power would be exercised when large numbers of cable systems are commonly owned. We concluded that concerns about anticompetitive behavior by large cable MSOs had been exaggerated and that, therefore, the Commission need not adopt stringent limits on the ownership of cable systems. This earlier conclusion is buttressed by developments since the passage of the 1992 Cable Act and the promulgation of the Commission's rules – most importantly the growth of Direct Broadcast Satellite subscribership – which support a relaxation of the limits the Commission previously adopted. In addition, there is now empirical evidence about the carriage behavior of vertically integrated Multiple System Operators that was not available at the time the rules were adopted. This new evidence demonstrates that the concerns of the Congress upon which the rules are based are largely unfounded. Together, these considerations indicate that the Commission can significantly relax its cable ownership restrictions without being concerned that this will lead to anticompetitive behavior by large MSOs.

Section II of this paper provides a summary of our original analysis that explained why the Commission should not be overly concerned about concentration in cable system ownership. In that analysis, we concluded that the only possible harm from horizontal integration is the exercise of bargaining power that could lead to a

[1] S.M. Besen, S.R. Brenner, and J.R. Woodbury, "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions," Attachment to Comments of Tele-Communications, Inc., In the Matter of Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition

reduction in the number or quality of program services, but that this outcome is unlikely. We also concluded that the Commission should not attach substantial weight to concerns about vertical foreclosure because the conditions required for profitable vertical foreclosure in the cable industry are unlikely to be met. In this section, we also explain why the growth of competition from other Multichannel Video Program Distributors (MVPDs) – especially the increase in DBS subscribership – has reduced whatever incentives may have existed for anticompetitive behavior by cable operators at the time the ownership rules were adopted.

Section III provides a summary of the economic evidence concerning the extent to which vertically integrated cable operators disfavor program services that compete with services in which they have an ownership interest. We conclude that there is little or no evidence that cable systems with program service interests have engaged in such strategies. Appendix A provides a detailed analysis of TCI's carriage behavior. We conclude on the basis of this analysis that TCI's carriage behavior is determined by which services are profitable to offer cable subscribers, without regard to the effect of those carriage decisions on TCI's competitive position in the supply of program services. Section IV describes how the growth of rival MVPDs should be taken into account in establishing a revised cable ownership cap. In particular, we explain why the ownership cap should be raised to reflect existing competition from DBS and why the Commission should adopt a rule that raises the cap automatically as competition from other MVPDs increases.

Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-trafficking Provisions, February 9, 1993.

II. Summary of the Conclusions of Our 1993 Analysis

It has been asserted that large cable MSOs could, by virtue of their size, reduce the prices they pay when they purchase program services. In addition, some have argued that large, vertically integrated cable MSOs might use their size as operators to foreclose program services in which they do not have ownership interests.

A. Efficiencies Obtained by Large MSOs

Any evaluation of the effects of a limit on cable system ownership must begin with an analysis of the efficiencies created by the existence of large MSOs. As the Commission acknowledged in its initial Notice,[2] significant efficiencies may result when cable systems in different geographic markets are under common ownership. Some of these efficiencies, which occur both in program acquisition and in planning and developing new technologies and services, would be lost if limits were placed on the number of subscribers that a MSO could serve.

A program service's costs can be reduced significantly if it can deal with a single entity that negotiates on behalf of a large number of separate cable systems. The reduction occurs because the service can negotiate with a single purchaser rather than having to reach an agreement with a large number of separate buyers and because marketing costs are reduced when a single decisionmaker can commit to taking a service for a large number of separate cable systems. Economies of scale also exist in administration and planning for new technologies and services. With regard to innovation, large MSOs have historically played a significant role in developing new services, encouraging the introduction of services developed by others, and in

[2] In the matter of Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations

supporting existing services through periods of financial difficulty. For these reasons, we concluded in 1993 that innovative activity in the cable industry would be adversely affected if stringent limits were placed on cable system ownership.

B. Direct Rivalry in Sales to Subscribers and Advertisers

In analyzing a merger, the primary competitive concern is that, by virtue of its larger share, the merged firm will, unilaterally or together with other firms in the market, increase prices to consumers. In the case of the cable industry, however, the suppression of direct rivalry among cable systems is not relevant. Cable operators typically do not compete with each other for subscribers or advertisers, since they almost always serve different geographic areas. Moreover, even if there were interdependent advertising demands across the areas served by adjacent cable systems, the cable systems would compete at a minimum with local broadcast stations and newspapers for those advertisers. As a result, the share of local advertising revenues accounted for even by all cable systems in any local advertising market will tend to be very small. Finally, while it is theoretically possible that the threat of overbuilding may be reduced by the acquisition of cable systems by a MSO, that threat is not likely to be competitively important because there have been so few instances of overbuild competition.

C. Purchases from Program Services

We concluded in our previous analysis that there is very little risk that the exercise of monopsony power poses a threat to the diversity and quantity of programming available to consumers. Even if large MSOs can affect the prices they pay for programming, they will have no incentives to restrict their purchases of cable

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and Anti-Trafficking Provisions, 8 FCC Rcd 210, at paras. 6, 34 (1993).

program services because they can reduce the price they pay for one service without also reducing the price they pay for others.

If a cable MSO were to carry an established service on more of its systems, the additional carriage would not require the expenditure of significant resources and, because there is no effect on the use of inputs by this service, there will be no effects on the cost that must be paid to retain inputs used by other services. Similarly, if a MSO decides to carry an additional service on all of its systems, few additional resources are needed to serve the additional systems, and thus the cost of inputs would not be raised. Therefore, there will generally be no incentive to inefficiently restrict the number of services purchased because the operation of an additional service is unlikely to increase the prices that must be paid to inputs used by other services.

Available evidence does not indicate that program services' input costs would be bid up in this way during any medium or long-term time horizon.[3] The rapid expansion of the number of cable program services that has occurred over the space of a few years, and the fact that many services continue to be available to cable systems at very low per-subscriber rates, suggest a relatively elastic supply of many of the inputs that are used by cable program services.

In addition, the ability to wield buyer power is diminished by the availability of alternative distribution outlets to which program suppliers can turn if a single cable operator, or a collection of operators, were to attempt to exercise such power. In particular, the rapid growth of DBS provides program suppliers with an increasingly important alternative to cable operators for the sale of their services.

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[3]Put somewhat differently, over these time periods the relevant antitrust market is not likely to be limited to those inputs used in producing specific types of program services.

Even where the behavior of a large MSO affects the quality of the program inputs used by program services, increases in program quality, although they may require the payment of higher input prices than those that are currently being paid, are unlikely to increase the costs of inputs used on other program services. As a result, even a single large buyer would obtain no benefits from restricting the amount of its purchases.

Indeed, when program quality considerations are important, increased cable system ownership may actually reduce the incentive for a cable operator to bargain for lower programming prices. If a cable operator purchases additional systems, the operator will take into account the fact that any reduction in programming quality induced by lower programming prices will reduce the profits of the newly acquired systems. As a result, the operator may have a smaller incentive to bargain for lower programming prices. In other words, large cable operators may have lower incentives than smaller ones to exert bargaining power that reduces program service quality.

In summary, we concluded in our earlier paper that the exercise of buyer power is unlikely to result in either a reduction in the number of program services or a reduction in the quality of service. Indeed, larger operators have an incentive to bargain less strenuously than smaller operators for lower program service prices.

D. Vertical Foreclosure

If large size gave cable MSOs the ability and incentive to foreclose rival services by refusing to carry them, giving them unattractive channel positions, charging consumers high prices for them, or through other means, some restrictions

on the size of MSOs might be justified. We concluded in our earlier paper, however, that there are significant barriers to pursuing a successful foreclosure strategy, a judgment that is reinforced by certain characteristics of the cable industry. This strengthens the view that a relatively high limit should be placed on the size of a MSO. In addition, the growth of DBS serves to reduce the gains from foreclosure because DBS provides an alternative outlet for program services that might be disadvantaged. This further supports our earlier conclusion.

In analyzing the question of whether large MSOs with interests in program services will engage in vertical foreclosure, it is important to recognize that the efficiencies that may flow from vertical integration between cable systems and cable program services must be balanced against any anticompetitive concerns. Although as a theoretical matter, we could not dismiss the possibility that a cable program service that is vertically integrated with a cable operator might be able to use that relationship to disadvantage a rival service, the set of circumstances in which such behavior would be profitable in the cable industry is sufficiently limited that we did not regard this as an important threat.

The concern that vertical integration may reduce competition and efficiency by restricting the supply of programming is based on the belief that a MSO may be able to disadvantage a program service that is an actual or potential rival of a program service with which the MSO is affiliated. The most overt form of such behavior would be refusal to carry the rival program service. In this story, because its rival is disadvantaged, the program service affiliated with the MSO is now able to raise its price to other cable operators, thereby increasing its profits.

However, we found that there are two basic reasons why a foreclosure strategy may be unattractive. First, the MSO may not have the ability to engage in the strategy. Second, even if it has the ability, the MSO is unlikely to have an incentive to engage in the strategy.

1. The Cable Operator May Lack the Ability to Foreclose a Rival Service

Refusing to carry a rival program service may not make it a less effective rival for a variety of inter-related reasons: the service may be profitable enough to absorb the loss of revenue; the service may be able to adjust its cost; and, given these factors, the MSO may not be large enough to impose sufficient harm to disadvantage the rival.

Moreover, the effectiveness of a foreclosure strategy is further weakened if other distributors can carry a rival service that the MSO tried to foreclose. In light of developments that have occurred since the passage of the 1992 Cable Act and the adoption by the Commission of rules limiting the size of MSOs — especially the rapid growth in the number of subscribers served by DBS operators — this factor places an especially important constraint on the ability of a large, vertically integrated MSO to foreclose a rival program service.

2. The Cable Operator May Not Have the Incentive to Foreclose

The ability of a MSO to disadvantage rival program services is necessary for the foreclosure strategy discussed here to succeed, but it is not sufficient. First, the foreclosure strategy may be too costly for the cable operator to pursue. When a cable operator chooses not to carry a program service that rivals its own (or to otherwise make it more difficult for subscribers to obtain access to the rival service), and the rival is valued by the cable operator's subscribers, some subscribers will choose to terminate

their cable service at the current price because the service is no longer attractive to them. Alternatively, subscribers may reduce their willingness to pay for cable service, thus reducing the price the operator can charge. Moreover, the growth of the DBS alternative, which has occurred entirely since the current rules were adopted, is likely to have increased subscriber responsiveness to a failure of a cable system to carry their preferred lineup of program services. Because of the relatively large difference between incremental subscriber revenues and costs experienced by cable systems (required by the high fixed costs associated with the cable system plant), even a loss of a small number of subscribers may be sufficient to eliminate the profitability of foreclosing a rival.

In addition, cable operators tend to share ownership of program services with other investors. If the cable operator disadvantaged a rival so that its affiliated service could raise its price, the cable operator would also be paying that higher price. If its financial interest in the program service is relatively small, the additional program service costs could easily outweigh its share of additional profits.

Equally important, eliminating one or a few rival program services may have little or no effect on the amount that other cable systems would be willing to pay for the program service owned by the foreclosing MSO. The program service owned by a MSO may be only one of many program services that are relatively close substitutes. These services, which need not carry the same type of programming, appeal to the same audiences, or even charge similar license fees, are substitutes so long as carrying any of them yields approximately the same incremental net revenue. In such cases, adding any one of these to a tier of services earns a cable system approximately